Back to Beginning of the Newsletter

Drafting Valid Noncompete Covenants in France and California

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In today's competitive global marketplace, employers find it more important than ever to protect their confidential information. On both sides of the Atlantic, employers find that they must increasingly guard against departing employees' taking their trade secrets and confidential know-how to a competitor. As a result, noncompete covenants are widely used in employment contracts both in the United States and France.

However, because the validity of these covenants is governed by local laws, employers cannot rely on a single, standard provision in all employment contracts wherever executed. Restrictive covenants in employment agreements executed in France are governed by French case law. In the United States, their validity is governed by the often widely divergent laws of whichever state's law properly governs the agreement (itself often a complex issue). Consequently, to ensure their enforceability, noncompete provisions must be drafted with a careful eye to the governing jurisdiction's requirements.

I. Non-competes in France

In France, noncompete covenants are not regulated by the Labor Code. Instead, their enforceability depends either on the applicable collective bargaining agreement (if any), or the employment contract itself.

To be valid under French employment law, a noncompete clause must:

1. be essential to protect the company's legitimate interests;
2. be relevant given the nature of the duties performed by the employee;
3. be limited in its geographical scope and duration; and
4. provide financial compensation.

Ordinarily, failure to comply with any one of these criteria renders the covenant null and void. In some instances, however, judges have found the covenant so necessary to protecting a company's legitimate interests that, rather than striking it in toto, they have altered its terms so that the employee is not entirely prevented from working. Each of the four criteria is discussed below.

1. Necessity of a company's legitimate interest

The "freedom to work" principle embodied in the French Constitution guarantees the right of departing employees to work for a competitor or to set up new businesses of their own. Consequently, noncompete covenants are valid only if their restriction on this freedom is essential to protect the company's interests.

French courts pay particular attention to whether a noncompete covenant unreasonably prevents employees from working and earning a living. To enforce a restrictive covenant, therefore, an employer must show there would be a detrimental impact on its business should the employee leave to work for a competitor. Conversely, an employee can invalidate the covenant by demonstrating that, due to his or her low level of qualifications or lack of access to his or her former employer's confidential information, the fact that he or she performs the same activity for a competitor would have no impact on the former employer's interests.

2. The nature of the employee's duties

A related requirement is that noncompetes must be relevant to the duties the employee performs. Effectively, this limitation prevents employers from enforcing the same covenant against all employees regardless of their training, education, professional skills, or level in the company.

Instead, covenants must consider the degree of access an employee has to confidential information, and must be adapted to the employee's professional skills and ability to find another job. For example, it would be difficult to bind a window washer to a noncompete covenant because, most likely, the window washer's job would not make him or her privy to confidential information critical to his or her former employer's operations. Conversely, noncompete covenants are common in employment contracts with executives who perform managerial duties and have substantial access to confidential information.

3. Time and geographical scope

Even if an employer has a legitimate interest for including a noncompete covenant, French courts have held that they must be limited in duration so as to not indefinitely prevent an employee from earning a living.

French courts have not set a maximum duration for noncompete covenants. Instead, they determine the maximum period on a case-by-case basis unless a collective bargaining agreement ("CBA") provides otherwise. When a CBA sets out a maximum duration, the employment contract cannot provide for a duration less favorable to the employee. In the absence of a CBA, however, courts generally find a period of one to two years to be reasonable.

The same reasoning applies to geographic scope. A noncompete provision applicable to Europe, the United States, and Asia would likely be found to be unenforceable as it would prevent the employee from working almost anywhere in the world. Thus, when drafting a noncompete covenant it is incumbent upon the employer to ensure that the geographical scope is reasonable given the nature of the employee's job. For example, the reasonable geographic scope of a salesperson's noncompete will likely be the region of France to which he or she had been assigned. If the salesperson had been assigned to Paris, the employer would list all the departments in Paris where the employee would not be permitted to work in a similar capacity after leaving the company.

4. Compensation

In the past, employers were not required to give financial consideration in exchange for a noncompete agreement unless required under the terms of a CBA. In a 2002 decision, however, the French Supreme Court reversed this policy. French case law now makes financial compensation mandatory for all noncompete covenants, even those entered into before the decision. Thus, any noncompete that does not contain a compensation component, no matter when executed, will be unenforceable.

However, only employees can void a noncompete clause for lack of compensation. Employers cannot use the absence of a compensation clause to void their own inadequately drafted contracts, thereby circumventing the payment of a reasonable financial consideration. In effect, the case law requires employers to indemnify employees who comply with a noncompete obligation that does not contain any compensation. Courts take the view that even if the covenant is not in compliance with French case law, the employee suffered a prejudice as he or she was unfairly deprived of the opportunity to work for a competitor.

French courts will also examine the value of the consideration for substantive fairness. A noncompete providing inadequate compensation is regarded as providing no compensation at all. Generally, courts consider compensation ranging from 30 percent to 50 percent of the employee's monthly salary to be reasonable unless a CBA provides for more.

Another consequence of this requirement is that employers must receive their employees' written consent if they wish to waive the application of the noncompete. Accordingly, unless a CBA provides otherwise, all noncompete covenants should reserve the right of the employer to unilaterally waive the noncompete obligation as well as the terms and conditions of the release.

In addition, the noncompete clause must state that financial compensation will be paid no matter the cause of termination (whether by resignation, dismissal, retirement, etc.). Thus, employers will owe an indemnity even if their employment contracts provide that noncompete compensation is forfeited upon dismissal. French judges have rationalized this policy by regarding a dismissal as an adequate penalty for any misconduct. It would be unfair, the courts have held, to penalize an employee twice by also depriving him or her of the noncompete compensation.

Finally, the financial consideration cannot be paid while the employment contract is in force, but must be paid after the employment relationship ends. As the French Supreme Court recently explained, this is because the consideration must be in proportion to the length of the noncompete period to be valid. If the actual employment period is shorter than the noncompete period—say, a two-year noncompete following just six months of work—the six months of consideration would be inadequate to compensate for a two-year covenant not to compete.

II. **Non-competes in California**

In the United States, California has an exceptionally strong policy in favor of employee mobility. Section 16600 of the Business and Professions Code voids ab initio "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind." Effectively, this section invalidates noncompete provisions that prohibit employees, upon completion of their employment, from working for a competitor. The rationale here is similar to that in France: California lawmakers and courts are concerned with the rights of departing employees to earn a living. Thus, the general rule is that all contracts to limit employee mobility are void under California law.

There are exceptions, however, and a number of related laws that permit employers to protect their business from unfair competition. Statutory exceptions to the general rule include the sale of a business and the dissolution of a partnership. Baring these circumstances, noncompete provisions will be enforced only if the employer can show they protect a very strong proprietary interest or property right of the employer, such as a trade secret.

1. <u>Sale of goodwill / Dissolution of a partnership</u>

Business and Professions Code Section 16601 carves out an exception to the general rule where stock, assets, or other interests in a business are sold and goodwill in a business is transferred. The rationale here is that the buyer who purchases a business because of its strong reputation should be able to rely on the seller's promise not to use that same reputation to compete against the buyer. Accordingly, a noncompete covenant may be enforceable against the seller of a business who agrees not to compete with the buyer in the same industry and geographic area. A noncompete of this type could potentially last as long as the buyer continues to conduct the same business in that location.

Similarly, Section 16602 authorizes noncompete agreements between partners upon disassociation from or dissolution of a partnership. A partner who leaves can be bound by a covenant not to compete against the partnership in a certain area for a certain length of time.

Although employers have attempted to use these exceptions to enforce noncompetes against their departing employees, California courts will examine the substance of the transaction to prevent this circumvention of public policy. For example, some employers have attempted to require all new employees to purchase a de minimis quantity of stock and then sell it back upon termination, thereby becoming the seller of "an ownership interest" under section 16601. Courts have seen through these attempts, however, and will almost always void a noncompete under these facts. Typically, requiring the sale of a inconsequential amount of equity (often less than 3 percent) will not save a noncompete.

2. <u>Nondisclosure Agreements and Protection of Trade Secrets</u>

While California employers may not prevent their departing employees from going to work for a competitor, they can prohibit them from using or disclosing confidential trade secrets in their new position. Section 16600 of the Business and Professions Code does not void contractual provisions that protect the employer's strong interest in its valuable proprietary information.

To protect this valuable information, California has adopted the Uniform Trade Secrets Act (UTSA), codified in Section 3426 of the Civil Code. This prohibits the "misappropriation" of trade secrets, defined as information that 1) derives independent economic value from not being generally known, and 2) is the subject of reasonable efforts to maintain its secrecy. Misappropriation includes both disclosing and knowingly acquiring trade secrets. Both compensatory and punitive damages may be available, as well as injunctive relief and attorney's fees. Under the UTSA, employers may enforce agreements not to disclose trade secrets and may pursue equitable or legal relief if secrets are disclosed. Commonly litigated trade secrets include marketing strategies, customer lists, secret product formulae, proprietary manufacturing techniques, and other closely-guarded, economically valuable information.

It is important to distinguish, however, between trade secrets, which are protected, and mere general knowledge or skill, which is not. An employer cannot use the UTSA to prevent a former employee from applying his or her general training or experience in a new job. Moreover, not all business information qualifies as a trade secret, even if it is valuable. Information that is publicly available through the Internet, trade magazines, telephone directories, etc. cannot qualify as a trade secret because its secrecy has not been adequately maintained.

Finally, California does not recognize the "inevitable disclosure" doctrine, which in many states allows employers to prevent employees from working for a competitor on the theory that they will inevitably disclose trade secret information they obtained on the job. California courts consider this doctrine to be a form of back-door noncompete, so they have refused to recognize it.

3. Nonsolicitation covenants

Nonsolicitation covenants that prohibit employees from soliciting the employer's customers for their own purposes are easily enforced during the employment relationship while the employee owes a duty of loyalty to his or her employer. However, a *post*employment nonsolicitation agreement is considered a form of covenant not to compete and is therefore subject to Section 16600. Thus, postemployment non solicitation agreements are enforceable only to the extent necessary to protect trade secret information.

The most common form of trade secret to be protected is the customer list. Not all customer lists are trade secrets, however; to qualify as a trade secret, a customer list must have been compiled with some significant expenditure of effort. For example, a general list that has been indexed or organized by noting customer preferences is probably a trade secret, while a mere list of names may not be. In any event, the UTSA would not prevent a departing employee from merely committing customer's names to memory, then contacting them from his or her new place of employment.

Similarly, although employees are prohibited from soliciting customers while employed, they are nonetheless free to *notify* customers that they intend to end their relationship with their employer and go into business for themselves. This notification would not run afoul of their duty of loyalty.

4. Termination for refusal to sign

Because noncompetes are unenforceable, terminating an employee for refusing to sign one can constitute a wrongful termination in violation of public policy. An employee who successfully challenges an unlawful noncompete may be entitled to both injunctive and declaratory relief, as well as attorney's fees.

5. Choice of law

Attempting to circumvent California's laws prohibiting noncompete laws, many employers have written choice of law provisions into their employment contracts to apply the more favorable laws of another state. This has been largely unsuccessful. Given the strong policy preference embodied in Section 16600, California courts will enforce a choice of law provision only if 1) the foreign law bears a substantial relationship to the parties, and 2) application of the foreign law does not offend California policy. In light of the strong California public policy against noncompete provision, it is not surprising that California courts generally apply California law wherever California employees are concerned.

Back to Beginning of this Newsletter